

VZCZCXRO8118  
RR RUEHAO  
DE RUEHCV #0009/01 0031548  
ZNR UUUUU ZZH  
R 031548Z JAN 07  
FM AMEMBASSY CARACAS  
TO RUEHC/SECSTATE WASHDC 7394  
INFO RUEHAC/AMEMBASSY ASUNCION 0745  
RUEHBO/AMEMBASSY BOGOTA 7172  
RUEHBR/AMEMBASSY BRASILIA 5844  
RUEHBU/AMEMBASSY BUENOS AIRES 1537  
RUEHLP/AMEMBASSY LA PAZ 2431  
RUEHPE/AMEMBASSY LIMA 0690  
RUEHMN/AMEMBASSY MONTEVIDEO 0893  
RUEHQT/AMEMBASSY QUITO 2521  
RUEHSG/AMEMBASSY SANTIAGO 3848  
RUEHAO/AMCONSUL CURACAO 1093  
RUEHGL/AMCONSUL GUAYAQUIL 0733  
RUEATRS/DEPT OF TREASURY  
RHEHNSC/NSC WASHDC  
RUEHRC/DEPT OF AGRICULTURE USD FAS  
RUCPDO/DEPT OF COMMERCE

UNCLAS SECTION 01 OF 02 CARACAS 000009

SIPDIS

SENSITIVE  
SIPDIS

TREASURY FOR KLINGENSMITH AND NGRANT  
COMMERCE FOR 4431/MAC/WH/MCAMERON  
NSC FOR DTOMLINSON  
HQ SOUTHCOM ALSO FOR POLAD

E.O. 12958: N/A  
TAGS: [ECON](#) [EFIN](#) [VE](#)  
SUBJECT: ENDING 2006 ON A HIGH

REF: A. CARACAS 1215

- [1](#)B. CARACAS 808
- [1](#)C. CARACAS 2718

[1](#)1. (SBU) SUMMARY: The Caracas Stock Exchange (BVC) is set to end 2006 at a record high (up 155 pct) as investors constrained by currency controls and sitting on piles of cash continue to seek out means to boost returns. As 2006 drew to a close, the BVC's high demonstrates the bubble mentality taking hold in Venezuela that, coupled with GDP growth above 10 percent, massive consumer spending, and rocketing real estate prices, raises the question of how long the party will last and how heavy the hangover will be when it ends. END SUMMARY.

[1](#)2. (U) Venezuelan GDP grew 10.3 percent in 2006, inflation ended the year at 17 percent and the money supply (M2) grew 68.3 percent, according to the Central Bank. These figures, driven primarily by government spending made possible by historically high oil prices, represent the highest growth and inflation rates in the hemisphere and follow the high growth rates of 2004 and 2005 (which were a result of both high oil prices and the country's economic recovery from the political turmoil of 2002 and 2003). Estimates are that Venezuela's GDP will grow between 7 and 9 percent in 2007, resulting in the longest period of consecutive growth in Venezuela in over 30 years.

[1](#)3. (U) The Caracas Stock Exchange (BVC) Index closed at 52,090 this year, up 155 percent over its closing level of 20,395 at the end of 2005, and up over 21 percent from a month ago. The upward trend continued throughout the electoral campaign and seems to have been unaffected by the results. This contrasts with 2005, during which time GDP grew by 9.6 percent, but the BVC Index fell 31.9 percent. The BVC is a small stock exchange, with a total capitalization of only USD 11.1 billion. Average trading volumes have increased from USD 4.5 million a day in January

to USD 19.4 million a day during December of this year.

¶4. (SBU) The demand for shares is driven primarily by the excess liquidity in the economy, a lack of alternate investment opportunities, and currency controls. With the official inflation rate running at 17 percent a year, interest rates paid on deposits are negative (bank CDs, for example, offer a 10 percent return). Additionally, the "private wealth management" business is booming in Venezuela, with most banks and advisors specializing in helping individuals diversify their portfolios (i.e. get part of their money out of Venezuela), through the purchase of shares convertible to American Depositary Receipts (ADR) or by debt swaps using so-called "permuta" transactions (reftel A). (Note: According to the BVC, 43 percent of the securities traded on the stock exchange in 2006 were ADRs. End Note.) A recent meeting with the head of the Advanced Finance Institute (PROTECT) revealed that there is a huge demand now for training and licensing stock brokers with existing firms expanding and new entrants coming in. He noted that there are only 140 or so licensed brokers in the country now, which meant that many firms had only one broker who had to sign off on the trades of dozens of employees. He also estimated that up to 80 percent of the business of the stock brokers in Caracas is now devoted to the parallel currency market and mentioned that ING and Merrill Lynch were looking to enter the market in Venezuela solely for this business. In 2006, the official exchange rate has been fixed at 2150 Bolivars/USD, however the parallel rate has grown from its range of 2600-2800 during 2004, 2005 and the beginning of 2006 to a high of 3,400/1 for a short period before December 3 presidential elections. It will probably end the year around 3,300/1. Speculation by investors on the spread between the

CARACAS 00000009 002 OF 002

official and parallel exchange rates have also driven the ADR market.

¶5. (SBU) The real estate market is also booming, with the price of residential buildings in the Caracas area increasing by around 36 percent this year. One real estate expert recently claimed that prime commercial real estate (e.g. higher-end shopping centers) in Venezuela's major cities now costs anywhere from USD 800 to 1200 per square foot, making it among the highest in the hemisphere. Both commercial and residential real estate have long been preferred investment vehicles as a hedge against inflation or devaluation, and historic shortages for housing (reftel B) all but guarantee that the seller's market will continue well into the future.

¶6. (SBU) COMMENT: The remarkable growth of the Venezuelan economy during the past three years is directly a result of historically high oil prices, which have allowed the government to increase spending by over 50 percent in dollar terms (does not include off-budget spending, reftel C). The fastest growing sectors of the economy (finance, construction, commerce and telecommunications) are rising on a wave of liquidity and in most cases do not represent structural changes in the economy that could provide for long term growth. Consumer credit (credit cards and vehicle loans) alone has grown almost 123 percent in 2006. The massive amounts of spending (from consumer goods to cars to apartments) is not sustainable and represents a bubble mentality where people feel that they have to get in now as prices will continue to go up. When oil prices or production begin to fall, the bubble may burst. END COMMENT.

WHITAKER